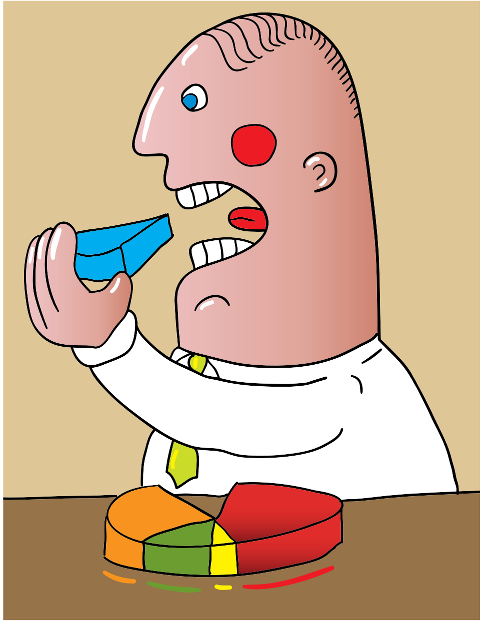
Health Spending—an Ever Larger Slice of the Pie



Individually and collectively by businesses and government, an ever-increasing proportion of our total consumption goes toward healthcare. The most widely used measure for the total dollar value of all goods and services produced in the U.S. economy is Gross Domestic Product (GDP). In 1960 healthcare accounted for 5.2 percent of GDP. The proportion of national production going to healthcare has steadily increased over almost 50 years to reach an estimated 16.6 percent of GDP in 2008.

Analysts who have studied the underlying causes of this dramatic growth in healthcare spending in recent decades cite the following reasons: New medical technologies and services are constantly emerging and becoming widely used. The major advances in medical science allow practitioners to diagnose and treat illnesses in ways that were not previously possible. Many healthcare innovations require costly new drugs, equipment and skills. New treatments also increase costs as they are rapidly adopted by an expanding number of patients. Of course, some technological advances do reduce spending, but overall, medical technology and clinical practices have overwhelmingly increased costs.

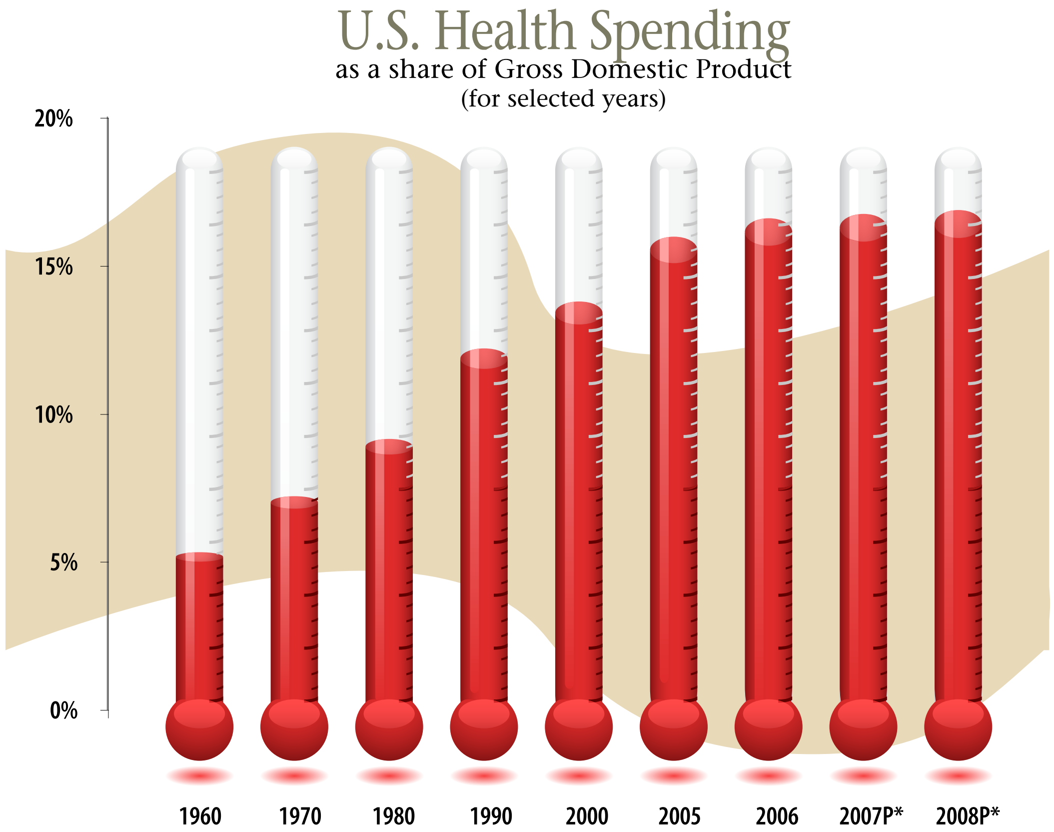
Over time, as our wealth increases, people naturally allocate more of their spending to healthcare. The demand for medical care tends to rise as real (inflation adjusted) family income increases. This result manifests itself in the increased use of insurance coverage in recent decades and the greater demand by consumers for healthcare goods and services to improve the quality and longevity of their lives.

With the growth of insurance coverage, as evidenced by a substantial reduction in out-of-pocket healthcare spending, more medical services are used than would otherwise be demanded if the costs were more directly borne by the consumer.

Another important source of medical spending growth is the aging of the population. As one ages, the demand for medical intervention increases. With the post World War II baby boom generation moving into their senior years, the demand for medical treatments and services will increase significantly.

Another way to look at the increase in healthcare spending is to compare overall consumer price inflation to medical price inflation (as measured by the consumer price index). From 1960 to 2008, medical inflation has been 2.24 times the overall increase in consumer prices.

It is interesting to note that the United States is the only modern industrialized country that does not provide some kind of healthcare coverage for all its citizens. Yet in 2007, out of the 30 most industrialized countries, the U.S. spent 16 percent of its GDP on healthcare, while no other country spent more than 11 percent.



P* = projections
Source: Centers of Medicare and Medicaid Services (CMS), Office of the Actuary.

As our wealth increases, we usually divvy out more of our spending on healthcare.

Medical inflation has been over two times the overall increase in consumer prices.